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10 July 2015

Senior Manager, OTC Derivatives Reform
Financial Market Infrastructure
Australian Securities and Investments Commission
Level 5, 100 Market Street
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Dear Sirs and Madams

**Consultation Paper 231: Mandatory Central Clearing of OTC interest rate derivative transactions ("Consultation")**

On behalf of the membership of the Futures Industry Association Asia ("**FIA Asia**") we welcome the opportunity to respond to the Consultation and the proposed *ASIC Derivative Transaction Rules (Clearing) 2015* ("**Draft Rules**").

FIA Asia represents a diverse group of participants in the exchange traded and centrally cleared derivatives industry. Our members include banking organisations, futures exchanges, clearinghouses, brokers, vendors and trading participants. FIA Asia is affiliated with FIA and FIA Europe. The alliance of our three associations, known as FIA Global, is the primary global industry association for centrally cleared futures, options and swaps.

Some of our members may have their own independent views on different aspects of the Consultation and may provide their comments to ASIC independently. Unless otherwise defined, capitalised terms used in this letter will bear the same meanings ascribed to them in the Consultation.

## 1. Executive Summary

We are supportive of the proposals to introduce central clearing mandates to certain interest rate derivatives which are broadly consistent with central clearing obligations in other jurisdictions.

An overarching view of our members is that the implementing rules proposed by ASIC need to be effective in limiting scope consistent with policy intent and approaches taken in other jurisdictions. Therefore our members are concerned that the current proposals are currently too wide in extra-territorial application. The strong view is that the clearing mandate should only apply to those derivatives that are 'booked in' Australia and should not have wider application. Limiting scope will assist in minimising unnecessary complexity, duplicative and potentially conflicting rules, costs and burdens on market participants.

We strongly support and encourage substituted compliance and regulatory recognition and 'equivalence' determinations for CCPs where possible. This will facilitate affected participants being able to clear through CCPs they are already using and provide them with a choice of CCPs to clear through.

We welcome the proposal that ASIC will 'prescribe' additional CCPs in certain circumstances. However, in the interests of transparency and to assist with market readiness, we encourage ASIC to make it clear which CCPs they are considering to be 'prescribed' and when they are 'prescribed'. This will assist in planning, minimising costs and streamlining operations and processes for market participants.

CCPs form the foundation of a healthy clearing system. We are aware that CCPs have become subject to increased scrutiny from regulators and market participants. In this regard, we wish to highlight a position paper that FIA Global has published recently, the FIA Global CCP Risk Position Paper[1], which makes recommendations for assessing and managing risks arising from clearing. The paper was written from the perspective of FIA Global's clearing member membership and their clients. We hope the paper is helpful and provides useful guidance.

In relation to the proposed timing and commencement of the Australian central clearing obligations, the strong view is that it would be preferable for Treasury and ASIC to continue to monitor the commencement date of clearing obligations in other jurisdictions and to align appropriately if there are time delays in other jurisdictions.

**2. FIA Asia Comments**

Our detailed comments on the Consultation are set out in the table at Annexure 1. We have only commented on those questions where we have specific feedback.

**3. Conclusion**

Thank you for your consideration of our comments.

We would be happy to meet with ASIC to discuss our comments and provide further information if required. Please contact Phuong Trinh .

Yours faithfully,

Bill Herder
President, FIA Asia

[1] https://fia.org/articles/fia-global-issues-recommendations-central-clearing-risks

## Annexure 1 – FIA Asia Comments

| Number | Question | Feedback |
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| **Entities subject to the clearing requirements** | | |
| B1Q1 – B1Q3 | Do you agree with the proposed scope of entities that may be subject to mandatory central clearing?<br><br>Do you agree with the proposed definitions of 'Australian clearing entity', 'foreign clearing entity', 'opt-in Australian clearing entity' and 'opt-in foreign clearing entity'?<br><br>What is the likely impact of our proposals? | **<u>Limit extra-territorial scope of clearing entities</u>**<br><br>The strong view is that the extra-territorial scope of the clearing mandate should be limited in nature and should only apply to OTC derivative transactions 'booked in' Australia and should not have wider application. Only applicable transactions that are booked in Australian branches should be subject to the clearing mandate.<br><br>To include 'entered into' in Australia (eg those with a sales person or trader nexus in Australia) transactions increases the potential for the Australian mandate to conflict with the rules in other jurisdictions. These transactions which are booked into an entity in another jurisdiction will be subject to central clearing obligations in those other jurisdictions. To capture these transactions under the Australian clearing mandate will result in unnecessary duplication, complexity and potential conflict. We believe this is inconsistent with the policy intent to increase efficiency, integrity and stability of financial markets through central clearing and the approach taken by other jurisdictions.<br><br>Including these nexus transactions will significantly increase the compliance, build and infrastructure costs associated with the mandate for foreign clearing entities and have a number of potentially negative outcomes.<br><br>By way of example, where a 'foreign clearing entity' is trading with a 'foreign internationally active dealer' across multiple time zones, there may be a situation where two identical transactions (both booked outside of Australia) entered into by the counterparties have different clearing requirements under the proposed Australian central clearing mandate. This could occur where the first transaction is conducted during NY hours and involves a NY sales person/ trader and the second transaction is conducted during Australian hours and involves an Australian sales person/trader. The risk profile of both transactions to the Australian market will be identical but the second transaction will be subject to the Australian clearing mandate and first transaction will not.<br><br>Where the above situation occurs, the first transaction may have been subject to an EU or US clearing requirement and the parties would be able to clear on the full spectrum of CCPs permitted under either the EU or US regulations (this is much wider than the limited list of CCPs licensed or prescribed in Australia). Then for the second transaction it will be required to be cleared via one of the limited list of Australian licensed or prescribed CCPs.<br><br>The above issue becomes even more complex where the first transaction is not required to be cleared (i.e. relates to a AUD product not yet subject to mandatory clearing in the EU or US or is with a 'foreign internationally active dealer' not yet mandated to clear under the EU or US requirements. If the second transaction was actually priced during NY hours by a NY trader (i.e. as an non-cleared transaction) but ended up being finalised by an Australian salesperson it would have to be re-priced and adjusted at point of trade to reflect it now is subject to a clearing mandate.<br><br>These complexities are going to significantly increase likely compliance and build costs for foreign clearing entities and foreign internationally active dealers and will have a likely effect on competition and the efficiency of the market. The complexities created by the inclusion of 'entered into' in Australia transactions could potentially result in an increase in systemic risk in Australia as foreign clearing entities may have to consider reducing the scope of transactions they arrange or execute from Australia and could result in reduced liquidity within the Australian market. |

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| | | Further concerns are set out in our responses to the B2 proposals.<br><br>**<u>Ability to expand scope</u>**<br><br>In other jurisdictions such as the US and under the proposed European rules, the clearing obligations extend beyond the major dealer community. Some of our members are of the view that there are other institutions that may warrant inclusion within the clearing mandate at some stage in the future. Therefore it is suggested that ASIC be conferred powers to expand the scope of the coverage of clearing entities subject to the clearing mandate if necessary and appropriate. This will assist with harmonising the Australian clearing mandate with clearing obligations in other jurisdictions if required for any third country comparability and equivalence assessments.<br><br>**<u>For clarification</u>**<br><br>The Draft Rules cover only those foreign entities that in addition to being an ADI, Exempt Foreign Licensee or financial services license holder are also a Part 5B2 registered or required to be registered foreign company. It is not necessarily the case that every ADI, Exempt Foreign Licensee or financial services license holder will also be a Part 5B2 registered or required to be registered foreign company. Irrespective of any overlap between the requirement to be registered as a Part 5B2 company and an entity's financial services licensing status, these remain two distinct regimes (the former being subject to analysis based on common law principles in addition to any statutory tests). Therefore one should not be conditional upon the other as forming part of the definition of a foreign clearing entity.<br><br>The Draft Rules do not include reference to a Foreign ADI whereas this is referred to in the Consultation Paper as an entity category.<br><br>We request that ASIC further consider these points and we would be grateful for clarification. |
| **Calculation of the clearing threshold** | | |
| B2Q1 | Do you agree with our proposal to adopt the clearing threshold set by the Australian Government of $100 billion gross notional outstanding in OTC derivatives, for entities other than those acting in a representative capacity? | We generally support the proposed clearing threshold of AUD 100 billion and understand this reflects many industry discussions conducted to date so that it is intended to only cover the largest dealers and in large part, current market practice.<br><br>However, many of our members are of the strong view that the clearing threshold calculation should be based on OTC derivative transactions booked into Australia only (as noted in response to B1Q1 – B1Q3). We understand the main policy intentions of the clearing mandate is to increase efficiency, integrity and stability of the financial markets in Australia. However, the 'entered into' concept was brought in to assist ASIC meet its market surveillance and transparency objectives. It is submitted that this inclusion is not required for the clearing mandate particularly when the market surveillance and transparency objectives have been achieved by the introduction of transaction reporting.<br><br>However, if ASIC is to continue to include 'entered into' in Australia transactions within the threshold calculation, it is of critical importance that it amends the current proposal to exclude "entered into" transactions entered into before 25 Feb 2015. As ASIC is aware from its work with the industry earlier this year on Instrument 15/0067, firms have faced significant challenges in identifying the 'entered into' historic transactions as the logic has required enhancements to the trade data being captured by firms, which cannot be applied retrospectively. This was one of the main reasons for a backloading period in respect to 'entered into' in Australia transactions under the Instrument being limited to those executed after 25 February 2015. For the same reason, we believe that only 'entered into' in Australia transactions executed after 25 February 2015 should be included in the calculation of the clearing threshold. |
| B2Q2 | Do you agree with the proposed application of the | The draft clearing rules require the trustee or the responsible entity to be incorporated in Australia or a registered foreign company. However the Corporations Act definition of |

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| | clearing threshold in relation to transactions entered into on behalf of a trust or registered scheme? | responsible entity has a narrower interpretation which excludes registered foreign companies under Part 5B2. Therefore, ASIC should consider whether the clearing rules should extend to foreign trustees and responsible entities in respect of foreign trusts and registered schemes. Without an Australian nexus, it would seem inappropriate to impose such clearing rules. |
| B2Q3 | Do you agree with the proposed derivatives that must be included when calculating the clearing threshold? | See response to B4 proposals |
| B2Q4 | Do you agree with our proposals for determining whether an Australian financial entity or foreign financial entity is a clearing entity, and when a clearing entity ceases to be a clearing entity? | See response to B2Q1 |
| B2Q6 | What is the likely impact of our proposals? | If ASIC is to continue to include 'entered into' in Australia transactions within the threshold calculation, it is of critical importance that it is not retrospective in effect, otherwise market participants will face significant implementation challenges. See response to B2Q1. |
| **Cross border scope of the clearing requirements** | | |
| B3Q1 | Do you agree with the proposal to apply the clearing requirements in each of the circumstances listed in proposals B3(a)(i)–B3(a)(v)? | Please see our response to B1 and B2 proposals |
| B3Q2 | Do you agree with our proposed definition of 'foreign internationally-active dealer'? | As highlighted in previous consultation responses, we believe the clearing mandate should only apply to transactions between Australian clearing entities and foreign clearing entities where they are above the clearing threshold. However, if Treasury and ASIC continue to move forward with requirements to extend the mandate to OTC derivative transactions entered into between foreign clearing entities and internationally active dealers then this should only apply to transactions booked in Australia by the foreign clearing entity. |
| B3Q3 | Do you agree with our proposed approach to defining 'nexus derivative', and to allow foreign clearing entities to opt-in to centrally clear nexus derivatives? | See response to B1 and B2 proposals |
| B3Q4 | Do you see any practical challenges for clearing entities trying to determine whether they are trading with an entity that is subject to the clearing requirements in each of the circumstances listed in proposals B3(a)(i)–B3(a)(v)? | We see considerable practical challenges as the rules are currently proposed. Even if there was a public list of applicable clearing entities due to the current inclusion of 'entered into' in Australia transactions, it will not be straight forward for 'foreign internationally active dealers' to determine pre-trade which of its in-scope transactions with a 'foreign clearing entity' will be subject to the Australia clearing mandate and which will not. This may necessitate significant changes to global practices for global banks. |
| B3Q5 | What is the likely impact of our proposals? (Please see page 4 for the information required.) | See responses above. |
| **Transactions and asset classes subject to mandatory central clearing** | | |
| B4Q2 | Do you agree with the | We do not believe it is appropriate to designate AUD denominated FRAs as subject to |

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| | proposed asset class specifications in proposal B4(a)and Table 2? | mandatory clearing at this stage. We understand no licensed CCPs are clearing this product and there is limited development of voluntary clearing in this product.<br>Further, some of our members are of the view that it is not appropriate to apply the clearing mandate to AUD denominated OIS. The main reason is that clearing access is limited as it is only available via one CCP at this stage and the timing of any alternative CCPs is currently unknown. |
| B4Q4 | Do you agree with our proposal to mandate central clearing of AUD-denominated forward rate agreements? If not, why not? | See B4Q2 |
| **Fulfilling the clearing requirements** | | |
| B5Q1 | Do you agree with our proposal to require clearing entities to clear each clearing transaction through a clearing facility? | We support this proposal. |
| B5Q2 | Do you agree with the proposed definition of 'cleared through' a clearing facility in the draft derivative transaction rules (clearing) attached to this consultation paper. Do you agree with our proposal to allow direct, indirect or client clearing arrangements to be used? | The 'cleared through' definition should accommodate clearing arrangements in foreign jurisdictions that adopt either the agency or principal models for clearing. Our understanding from the Consultation Paper is that ASIC does intend this to be the case (however this does not appear to be reflected in the Draft Rules).<br><br>Confirmation of this should be provided and specifically for those foreign jurisdictions in which the Government have prescribed CCPs and jurisdictions that ASIC intend to prescribe CCPs for the purposes of alternative clearing under the Draft Rules. Without such confirmation, the clearing entity will not be able to satisfy the requirement to clear and be considered in breach of the clearing provision (as a consequence of the clearing model being used). Draft rule 2.1.1 covers clearing based on the principal model (as opposed to agency) where each Clearing Entity is a participant at the CCP and where each Clearing Entity is not a participant at the CCP but instructs a participant to clear on its behalf. |
| **Deadline for mandatory central clearing (generally T+1)** | | |
| B6Q1 | Do you agree with our proposed deadline of T+1 for the clearing of clearing transactions? | Generally yes but the deadlines should be consistent with other jurisdictions especially if nexus transactions are to be considered within the scope of the clearing obligation. |
| **Clearing through clearing facilities**<br>**Prescription of clearing facilities** | | |
| C1Q1 | Do you agree with our proposal to allow clearing entities to be cleared through licensed CS facilities or prescribed CCPs? | We would encourage ASIC and the Treasury to work on prescribing as many CCPs as possible to allow for market participants to have a choice of CCP and to allow market participants to use CCPs they are already clearing through to minimise any market disruption. In the interests of transparency and market readiness, we request that ASIC make it clear which CCPS they are intending to 'prescribe' and when they are 'prescribed' so that participants are aware of which CCPs can be utilised. |
| **Clearing in accordance with foreign clearing requirements (alternative clearing)**<br>**Who can access alternative clearing?** | | |
| D1Q1 | Do you agree with our proposal to allow any clearing entity to comply with mandatory central clearing by using alternative clearing? If not, do you think the scope of our proposal should be narrower (e.g. restricted to | No objection raised. |

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| | foreign clearing entities)? | |
| D1Q2 | Do you believe that access to alternative clearing would assist clearing entities to meet their clearing requirements? | As highlighted in the Consultation, it was agreed in April 2013 that clearing requirements should generally not apply to derivative transactions already subject to mandatory clearing in another jurisdiction except where:<br>(a) a category of counterparty or products are exempt from mandatory clearing in one jurisdiction but not in another; or<br>(b) a product is subject to mandatory central clearing in one jurisdiction but not in another.<br>The view is that the current proposal by ASIC that transactions need to be cleared via a prescribed or licensed CCP is inconsistent with this agreed approach. This is especially relevant as there are only a limited number of CCPs licensed or prescribed under the proposed regulations. We note this approach is not consistent with the approach taken in other jurisdictions (eg EMIR under Article 13 where equivalence considers the equivalence of the clearing requirements and does not include further specific venue requirements).<br>We request that the Australian clearing requirements allow a foreign entity that is required to clear a particular transaction under substantially equivalent rules to be able to clear such transaction on any CCP permitted under such substantially equivalent rules.<br>We also encourage ASIC and the Treasury to work on prescribing as many CCPs as possible to allow for market participants to have a choice of CCP and to allow market participants to use CCPs they are already clearing through to minimise any market disruption. In the interests of transparency and market readiness, we request that ASIC make it clear which CCPS they are intending to 'prescribe' and when they are 'prescribed' so that participants are aware of which CCPs can be utilised. |
| D1Q3 | What is the likely impact of our proposals? | Many 'foreign internationally active dealers' and 'foreign clearing entities' incorporated in 'equivalent' jurisdictions may not have access to the limited list of prescribed or licensed CCPs currently proposed.<br>By mandating that these entities clear on a smaller number of CCPs than they are currently able to clear on under equivalent overseas legislation will effectively prevent them trading with certain counterparties and other clearing entities. This will reduce competition and potentially increase costs and reduce liquidity. |
| **Conditions for access to alternative clearing** | | |
| D2Q2 | Do you agree with our proposal that derivative transactions using alternative clearing must be cleared through a licensed CS facility or prescribed CCP? | See comments to D1Q2 above. |
| **Intra-group exemption** | | |
| E1Q1 | Do you agree with our proposal to allow an exemption from the clearing requirements for intra-group derivative transactions? | We understand the proposed intra-group exemption reflects industry discussions conducted to date. |
| E1Q2 | Do you have any feedback on the notification requirements? | We request ASIC to consider a post-notification of reliance on the intra-group exemption (rather than prior notice under the current proposal) to retain the ability to hedge or execute transactions if and when needed. This also provides ASIC with certainty that a transaction has occurred (and an intention that others may follow in the future) as opposed to prior notice where a change in circumstances may mean that the transaction does not proceed. |
| **Multilateral compression exemption** | | |
| E2Q1 | Do you agree with our proposal to allow an exemption from the clearing requirements for | We welcome the proposed exemption from the clearing requirements for transactions that are created as part of a multilateral trade compression cycle. However, we request that the exclusion is expanded to also cover bilateral compression processes.<br>New and amended trades that result from systemically risk-reducing processes such as |

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| | transactions that are created as part of a multilateral trade compression cycle? Are there any conditions that should be placed on this proposed exemption? | compression (whether via a multilateral trade compression cycle or a bilateral compression processes) should not be subjected to the clearing mandate if the original trades were themselves not subject to the clearing mandate. If these post-trade risk reduction trades are not exempted, this would act as a significant disincentive for firms to participate in both multilateral and bilateral compression exercises and introduce new pricing risks for market participants. In addition, subjecting resultant trades to the clearing obligation could also undermine other risk mitigation requirements faced by foreign clearing entities such as under EMIR in Europe. |
| E2Q2 | Do you agree with our proposal not to allow an exemption from mandatory central clearing for bilateral compression exercises? | See our response to E2Q1. |
| **Notification of status as a clearing entity** | | |
| F1Q1 | Do you agree with our proposal to require entities to notify us when they become, or cease to be, a clearing entity? If not, why not? | Agree. |
| F1Q2 | If proposal F1(a) is implemented, should ASIC publish a list of clearing entities on an ongoing basis, based on the notifications provided to us? Are there any practical benefits in ASIC publishing a list based on notifications from clearing entities (taking into account existing industry mechanisms for providing notifications about an entity's regulatory status)? | To help reduce any legal uncertainty we believe it is imperative that ASIC publishes a list of clearing entities on an ongoing basis. |
| **Record-keeping requirements** | | |
| F2Q1 | Do you agree with our proposal to require clearing entities to maintain records demonstrating compliance with the clearing requirements for a period of five years? | No objection raised. |
| F2Q2 | Do you agree with our proposal to require clearing entities to provide us with these records upon our request? If not, why not? | We are comfortable on the basis that it allows for records to be provided within a reasonable time frame. |
| **Commencement of mandatory central clearing** | | |
| G1Q1 | Do you agree with the proposed commencement date of 4 April 2016 for mandatory central clearing (for those entities that are at or above the clearing threshold as at 30 September 2015 and 31 December 2015)? | We strongly encourage ASIC to continue to monitor the commencement date of clearing obligations in other jurisdictions (eg. Europe). If there are delays with commencement in other jurisdictions we request that ASIC and Treasury align the proposed commencement timelines accordingly in the interests of regulatory harmonisation and consistency. |